STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
	:	
	:	11-0721
Formula Rate Tariff and Charges Authorized by Section 16-108.5 of the Public Utilities Act.	:	

ILLINOIS INDUSTRIAL ENERGY CONSUMERS STATEMENT OF POSITION

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ILLINOIS INDUSTRIAL ENERGY CONSUMERS
STATEMENT OF POSITION

COME NOW the Illinois Industrial Energy Consumers ("IIEC") and pursuant to the direction of the Administrative Law Judges ("ALJs") in this docket, provide the following Statement of Positions.

A diverse group of large electricity consumers, Abbott Laboratories, Inc., Caterpillar Inc., Chrysler Corporation, Corn Products International, Inc., Enbridge Energy, LP, General Iron Company, Sterling Steel Company and Thermal Chicago, intervened in this proceeding. They refer to themselves collectively as the Illinois Industrial Energy Consumers ("IIEC" or "IIEC Companies"). Pursuant to Section 200.800 (83 Ill. Adm. Code Part 200.800) of the Rules of Practice of the Illinois Commerce Commission ("ICC" or "Commission"), and the briefing schedule set by the Administrative Law Judges, the IIEC Companies named above present their Statement of Position in this docket for the Commission's consideration.[1]

B. The Formula Rate Framework

1. Formula Rate Regime

IIEC points out that Section 16-108.5 effects significant changes in this Commission's approach to setting rates for ComEd's regulated distribution delivery service. That statute prescribes a formulaic determination of ComEd's return on equity, it requires formalization (in tariff form) of the revenue requirement equation that the Commission has traditionally used, it institutes a process for reconciliation of ComEd's rates (but not its actual revenues) with ComEd's costs, based mainly on its FERC Form 1 data, and it establishes an earnings collar that allows ComEd's actual earnings to vary by as much as 50 basis points from the formula cost of equity used to set rates. (*See* 220 ILCS 5/16-108.5).

IIEC notes that other aspects of the Commission's regulation remain essentially unchanged. Indeed, Section 16-108.5 emphasizes repeatedly the Commission's duty to maintain (if not intensify) its Article IX review of all costs (with the single exception of ComEd's return on equity) included in the determination of the utility's revenue requirement. (220 ILCS 5/16-108.5(c)(3)). Article IX is referenced nine times in Section 16-108.5 IIEC observes the adequacy of the Commission's regulatory oversight, the propriety of its determinations of prudently incurred, reasonable costs and of whether the rates imposed on ratepayers are just and reasonable depend on the Commission's recognition and diligent performance of this statutory duty under Article IX.

[1] This Statement of Positions follows the agreed outline for briefs in this proceeding. Captions relevant to the issues addressed by IIEC are in **bold** typeface in the Table of Contents to the brief. IIEC has inserted additional sub-captions where needed to better organize same.

IIEC argues that ComEd claims – falsely – that under the new formula rate and reconciliation regime, which is being implemented for the first time in this case, ComEd's ratepayers will "pay no more and no less than ComEd's actual costs." (*See*, Hemphill, ComEd Ex. 20.0 at 6:121-123). IIEC points out, in fact, the statutory reconciliation adjustment takes no consideration of the amount ratepayers have actually paid and makes no adjustment for excess or insufficient amounts paid by ratepayers. (Hemphill, Mar. 7 Tr., at 144-146; *compare* 220 ILCS 5/16-108.5(c)(5) and 220 ILCS 5/16-108.5(c)(6)). IIEC confirms the reconciliation is of only the "revenue requirement [based on projected costs] effected in rates" and "what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date." (220 ILCS 5/16-108.5(c)(6)). IIEC states ComEd's revenues (what customers pay) are not reconciled to its actual costs, and its revenues may vary widely from those costs, since they are not limited directly by the statute or any effect of the reconciliation. (Hemphill. Mar. 7 Tr. at 146). IIEC notes that ComEd's revenues are constrained only indirectly by an earnings collar that permits large differences between the amount ratepayers pay and the prudent, just and reasonable costs ComEd actually incurs in providing service. (220 ILCS 5/16-108.5(c)(5)).

IIEC argues that ComEd has used its claim that ratepayers will pay no more and no less than ComEd's actual costs as a justification for mechanistic treatments of its proposed costs. (*See*, *e.g.,* Hemphill, ComEd Ex. 20.0 at 4-14:83-295). IIEC opines that a reconciliation that does not actually remedy over-collections from ratepayers cannot reasonably be the basis for lessened scrutiny of proposed costs that could inflate rates and the dollars customers actually pay. Because revenues are not reconciled to costs, the statutory reconciliation offers no firm prospect of correction or restitution through the annual reconciliation of rates. These factors increase the importance of vigorous regulatory review. IIEC observes that, consistent with that view of the Commission's role, the General Assembly (in Section 16-108.5) has repeatedly mandated full Article IX reviews of formula rate proposals.

2. Commission Authority/Duties and Statutory Standards

IIEC argues Section 16-108.5 explicitly commands that the Commission continue its scrutiny of proposed costs and rates in accordance with existing Article IX of the PUA, relevant law, and the Commission's customary practice, with very limited exceptions.

> The Commission shall initiate and conduct an investigation of the tariff in a manner consistent with the provisions of this subsection (c) and the provisions of Article IX of this Act to the extent they do not conflict with this subsection (c).
>
> * * *
>
> Such review [of proposed rates and tariffs] shall be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred

> by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act.
> (220 ILCS 5/16-108.5(c)).

Thus, any suggestion that a formula rate – even when incorporated in a tariff – displaces the Commission's rate setting function or diminishes its review authority (except where a conflict with statutory formula rate requirements in Section 16-108.5(c) exists) has been expressly rejected by the General Assembly.

IIEC asserts the Commission is not authorized to forego this mandated rigorous Article IX review of proposed costs and rates, in deference to numbers that appear in an annual ComEd filing with another regulatory body (its FERC Form 1). "Nothing in this Section is intended to allow costs that are not otherwise recoverable by virtue of inclusion in FERC Form 1." (220 ILCS 5/16-108.5(c)). IIEC notes that, even in adopting FERC filings as a starting point for future formula rates, Illinois' General Assembly expressly required that:

> The performance-based formula rate approved by the Commission shall do the following:
>
> > (1) Provide for the recovery of the utility's <u>actual</u> costs of delivery services that are <u>prudently</u> <u>incurred</u> and <u>reasonable</u> in amount <u>consistent with Commission practice and law</u>.
>
> * * *
>
> Nothing in this Section is intended to allow costs that are not otherwise recoverable to be recoverable by virtue of inclusion in FERC Form 1. (220 ILCS 5/16-108.5(c) (emphasis added)).

According to IIEC, the first requirement of – and the first <u>limitation</u> on – Illinois' formula rate process is that it "[p]rovide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." (220 ILCS 5/16-108.5(c)(1)). As noted, that consistency expressly includes the provisions of Article IX of the PUA, "to the extent they do not conflict with this subsection (c)." (220 ILCS 5/16-108.5(c)). IIEC asserts that with respect to the most consequential contested proposals in this case, there is no such conflict – adherence to the directives of both Article IX and new section 16-108.5 is possible, required, and sensible.

IIEC argues that ComEd's proposed implementation of the PUA's provisions, however, may create conflicts that do not exist in the statutory provisions themselves. IIEC cites, for example, Section 16-108.5's requirement that ComEd recover only its "actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law" is fully consistent with the limitation, in Section 9-211 of the PUA, on the Commission's authority to approve excessive rate base amounts. (220 ILCS 5/16-108.5(c)(1);

220 ILCS 5/9-211)). ComEd proposes to augment the projected plant additions permitted under Section 16-108.5 by the use of year-end rate base amounts – instead of its actual capital costs reflecting only the "value of such investment . . . prudently incurred and used and useful in providing service" during the rate period. (220 ILCS 5/9-211). This creates an easily avoidable violation of the statutory limitations. (220 ILCS 5/9-211).

IIEC points out moreover, that nothing in Section 16-108.5 "is intended to legislatively overturn the opinion issued in *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, Nos. 2-08-0959, 2-08-1037, 2-08-1137, 1-08-3008, 1-08-3030, 1-08-3054, 1-08-3313 cons. (Ill. App. Ct. 2nd Dist. Sept. 30, 2010)." (220 ILCS 5/16-108.5(j); *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 405 Ill. App. 3d 389 (2nd Dist. 2010)). That decision held that Section 9-211's limitation encompassed both historical and projected rate base costs used to set rates. It did so even though the rate base adjustment at issue (accumulated depreciation) was not specifically named in a Commission rule. (405 Ill. App. 3d at 405). The substance of that decision was affirmed (and extended to ADIT) in a recent Ameren appeal. (*Ameren Illinois Company v. Ill. Commerce Comm'n*, Nos. 4-10-0962, 4-10-0976, 4-11-0075 cons. (Ill. App. Ct. 4th Dist. Jan. 10, 2012)).

IIEC says ComEd also argues that recognizing the effect of ADIT on its projected rate base and capital costs is barred, because ADIT is not specifically mentioned in Section 16-108.5 and will be "caught" in reconciliation charges. (Fruehe, ComEd Ex. 22.0 at 6-7:130-149). However, IIEC points out that ComEd's interpretation and application of the statute would preclude the Commission's performance of its duty to determine the amount of ComEd's prudently incurred, reasonable costs used to provide service -- and to use only those costs in setting its rates. (220 ILCS 5/9-201(c); Hemphill, Mar. 7 Tr. at 142 (agreeing that "ComEd is entitled to earn only on the investment used to provide service"). ComEd's second argument is essentially meaningless, since all deviations from costs of service -- no matter how unreasonable -- will be caught in reconciliations. But as ComEd's Dr. Hemphill testified, the promise of a later reconciliation does not allow the Commission to approve a rate base or a rate that is not prudent, just and reasonable. (Hemphill, Mar. 7 Tr. at 141).

Likewise, ComEd's insistence on using its actual capital structure without more in determining the capital costs included in rates would interfere with the Commission's obligation to approve a capital structure "subject to a determination of prudence and reasonableness consistent with Commission practice and law." (220 ILCS 5/16-108.5(c)(2)).

IIEC argues the Commission's obligation to recognize only prudent and just and reasonable costs for use in the formula rate calculations requires that, wherever practicable, the Commission must take account of both projected costs and projected cost offsets that significantly affect the formula rate revenue requirement. IIEC states a deliberate knowing calculation of an excessive revenue requirement that excludes significant offsets to projected costs is neither just and reasonable nor lawful.

3. The Commission Practice Standard

IIEC points out that a performance-based formula rate is to provide for the recovery of actual costs "prudently incurred and reasonable in amount consistent with Commission practice and law." (220 ILCS 16-108.5(c)). IIEC states that certain new matters, like reconciliation issues, have no direct precedent in prior Commission practice. However, the IIEC argues the broader directives to the Commission -- to allow only prudently incurred, reasonable costs and to assure just and reasonable rates -- are supported by ample precedent in Commission practice to provide guidance for any novel demands of a formula rate regime.

IIEC notes, in addition to statutory imperatives (prudence, just and reasonable), the Commission's established practices include adherence to a policy of cost causation and to ratemaking principles like rate stability and gradualism. Cost causation in particular requires rates that reflect ComEd's prudent and reasonable costs as accurately as practicable; such accuracy also supports the statutory requirements.

> The formula rate statute requires rates to be just and reasonable. Therefore, a more accurate measurement of ComEd's actual cost of service during the initial rate period and subsequent rate years is needed. (Gorman, IIEC Ex. 2.0 at 4:99-101).

IIEC contends that it is apparent from the incorporation of a reconciliation process that an accurate measure of ComEd's cost of service is "a clear objective of the formula rate." (Gorman, IIEC Ex. 2.0 at 3:66-67).

IIEC states the Commission's consistent focus on cost causation should have the effect of minimizing the charges or credits needed to reconcile revenue requirements based on projected costs with revenue requirements based on actual costs for the same rate period.

> Generally, it seems appropriate to try to obtain the most accurate cost of service projection that is practicable, thus minimizing the burdens of over-recovery for ratepayers or under-recovery for ComEd pending completion of a reconciliation process. (Gorman, IIEC Ex. 2.0 at 11:259-262).

IIEC argues that approach also advances the principles of rate stability and gradualism that are elements of the Commission's regular practice. IIEC notes the consensus of major parties in this case is that minimizing the magnitude of corrective reconciliation adjustments is the proper path to just and reasonable rates. (*See, e.g.,*Gorman, IIEC Ex. 2.0 at 11:259-262, 3:64; Effron, AG-AARP Ex. 2.0 at 24:398-408; Hemphill, ComEd Ex. 20.0 at 8:162-168 and Mar 7 Tr. at 126, 138, 140). IIEC argues that, absent an irreconcilable conflict with required elements of the formula rate, those established practices and principles of the Commission's Article IX regulation have been preserved by the formula rate statute. (220 ILCS 5/16-108.5(c)). IIEC states the Commission's primary objective in each formula rate proceeding should be identical to its objective in other proceedings subject to Article IX regulation -- the most accurate determination of ComEd's costs of service (revenue requirement). IIEC argues the Commission's objective should not be subordinated to excessively narrow constructions of statutory language or to blind repetition of formula calculations, nor diminished by the mere prospect of a reconciliation. (Gorman, IIEC Ex. 2.0 at 5:106-113; Hemphill, Mar. 7 Tr. at 141). IIEC insists that an accurate determination at each stage of the two-part formula rate process is imperative, since – as ComEd acknowledges -- "[t]here is no reason to assume that every dollar of reconciliation charge will be offset by an equal amount of credit in future years" (Fruehe, ComEd Ex. 22.0 at 29:641) and inaccurate cost projections "will increase the aggregate error term and hurt customers and utilities alike" (Hemphill, ComEd 20.0 at 11:220-222).

C. ComEd's Filing

IIEC argues the substance of ComEd's formula rate filing and its proposed rates rest on a series of contradictory arguments, deployed as needed to support its proposals. With respect to issues of consequence in setting ComEd's rates, the alleged "simplicity, certainty, and accuracy" (Hemphill, ComEd Ex. 20.0 at 6:120-121) of formula ratemaking are discarded in favor of inconsistent positions that favor ComEd's proposals.

IIEC points out that ComEd narrowly construes Section 16-108.5, but not consistently so. ComEd argues that recognition of projected changes in accumulated deferred income taxes is barred simply because "the Act is silent" on including that rate base component (Fruehe, ComEd Ex. 22.0 at 7:145). Similarly, Ms. Houtsma would reject a more accurate average-year rate base amount because that figure (just like a year-end amount) is not specifically mentioned in Section 16-108.5. (Gorman, IIEC Ex. 2.0 at 2:38-45). However, IIEC notes ComEd does not find the clear statutory directive for cost allocations "consistent with the Commission's most recent order" a constraint on its proposal to alter the jurisdictional cost allocations used in that case (Dkt. 10-0467). (220 ILCS 5/16-108.5(c); *See*, Houtsma, ComEd Ex. 12.0 at 31:676-678).

IIEC points out that ComEd has proposed a tariff of incredible detail and complexity to implement the formula rate statute.(Gorman, IIEC Ex. 1.0-C at 9-10:194-215). IIEC states that while Section 16-108.5(c) permits a formula rate, it does not displace the Commission's role in setting rates. Section 16-108.5 simultaneously emphasizes the Commission's Article IX authority to determine the formula's prudent and reasonable cost of service inputs (for costs other than the return on equity) (*See* 220 ILCS 5/16-108.5(c)(1) and (c)(3)).

IIEC notes ComEd's proposed tariff contains dozens of pages of spreadsheets, filled with arcane variables and references to even more spreadsheets, most of which are not in the tariff. (*See* Houtsma, ComEd Ex. 2.1; Fruehe, ComEd Ex. 22.1, 22.2). IIEC argues that rather than providing simplicity, certainty, or clarity (for ratepayers or the Commission), ComEd unnecessarily complicates the Commission's review, threatening to diminish the Commission's defined role. (Gorman, IIEC Ex. 1.0-C at 9-10:205-215).

IIEC suggests that the proposed tariff's detailed spreadsheets may require revision simply to implement Commission determinations that certain costs included in amounts shown on a FERC Form 1 do not meet Article IX standards. (*See, e.g.,* Fruehe, ComEd Ex. 13.0 at 40:851-

857 (changes to implement a Staff recommendation); ComEd Ex. 22.8)). IIEC notes a lengthy list was needed to show changes to the tariff and supporting documents that were required by ComEd's own revisions of the revenue requirement calculation. (*See* Houtsma, ComEd Ex. 12.9; Fruehe, ComEd Ex. 22.8). IIEC argues the task of crafting, ordering and verifying similar revisions scattered through nearly 200 pages of tariff, tariff appendix, and workpaper spreadsheets, potentially for each Commission cost determination that varies from what ComEd proposed, can present significant practical obstacles to the Commission's performance of its duties.

D. Staff and Intervenor Positions and Proposals

IIEC notes that the testimony of intervenor parties presents several shared concerns. Foremost is the common realization that accurate cost of service determinations are critical at each stage of the formula rate process. Of particular concern is the revenue requirement determination, which is based partly on ComEd's distortion of its rate base costs and its selective inclusion of elements that make up the Company's projected costs. (*See, e.g.*, Gorman, IIEC Ex. 1.0-C at 24:545-555; IIEC Ex. 2.0 at 10-12:222-276, Effron, AG-AARP Ex. 2.0 at 14:296-299, AG-AARP Ex. 4.0 at 12-13:274-278; Smith, CUB Ex. 3.0 at 13:261-264, 40-41:875-893). IIEC argues the statutory reconciliation process does not reconcile what customers paid with ComEd's costs of service. (*See* IIEC Cross Ex. 1. P.2 of 3; Hemphill, Mar 7 Tr. at 145-146). Thus, IIEC finds there is a real danger that the customer overpayments resulting from erroneous determinations will never be recovered from ComEd. IIEC states ComEd's proposed implementation of the statute includes projected additions to rate base, but can exclude contemporaneous decreases to rate base, (Gorman, IIEC Ex 1.0-C at 11:255), exacerbating that peril of unrecoverable over-collections.

IIEC contends, that fundamental disconnect in the design of the reconciliation process (reconciliation of costs, not revenues) magnifies the importance of Commission oversight under PUA Article IX, as there is no readily apparent remedy when customer payments exceed ComEd's actual rate year costs, even after the reconciliation. Therefore, IIEC believes it is important the Commission exercise its authority under Article IX in a manner that insures that only ComEd's prudent and reasonable costs, determined as accurately as possible, are reflected in ComEd's formula rate at any given time.

II. OVERALL REVENUE REQUIREMENT

A. Revenue Requirement Amount

IIEC did not propose a specific overall revenue requirement. However, IIEC has recommended that the Commission modify ComEd's proposed treatment of certain costs that are submitted for the Commission's use in setting the utility's formula rates.

B. Initial Determination

IIEC finds, by statute, this case must examine ComEd's proposed formula rate and make the initial determination of its revenue requirement and rates under the formula process. IIEC notes Section 16-108.5 of the PUA treats a Participating Utility's initial formula rate determination in a unique manner. IIEC points out in particular, for these initial determinations the statute utilizes certain cost inputs and calculations that are available for this proceeding, but will not be available for or used in future reconciliation and rate year proceedings. (*See* 220 ILCS 5/16-108.5(c) and (d); IIEC Cross Ex. 1. P.3 of 3). Like Section 16-108.5, the Commission must recognize the unique nature of this proceeding and the resulting rates. IIEC believes the Commission should reject arguments that urge the Commission to curtail efforts to measure more accurately ComEd's costs of service during the relevant rate period, in a misguided attempt to replicate a unique event. (*See* Houtsma, ComEd Ex. 12.0 at 32:712-714). IIEC finds repeating the singular initial formula rate setting in every iteration of formula ratemaking is illogical, and it is inconsistent with the distinctive treatment of this first formula rate proceeding under Section 16-108.5.

III. RATE BASE

A. Overview

IIEC argues the fundamental premise of the formula rate process is to set rates to recover ComEd's actual costs of service during specific rate periods, through a combination of (a) rates based on projected costs for that period and (b) later reconciliation charges or credits intended to achieve a match with the utility's reported actual costs during that same period. (Hemphill, 7 Mar. Tr. at 131; 220 ILCS 5/16-108.5(d)(1)). IIEC notes ComEd's capital costs are a major component of that revenue requirement, and they must be measured accurately, if the Commission is to set just and reasonable rates that reflect only ComEd's prudently incurred, reasonable costs. (Gorman, IIEC Ex. 2.0 at 4:99; Fruehe, ComEd Ex. 22.1, Sch. FR A-1). IIEC asserts that, since rate base is one of the two factors that determine ComEd's cost of capital, the Commission's determination of ComEd's rate base is critical.

IIEC has identified three issues in ComEd's proposed calculation of rate base that directly affect the accuracy of the Commission's determination of ComEd's actual costs. The first issue is ComEd's proposal to use the year-end rate base amount reported in its FERC Form 1 as its investment for the entire calendar year rate period. (Gorman, IIEC Ex. 1.0-C at 23:529-530, 24-25: 537-576). IIEC has opposed ComEd's proposal because of the obvious inaccuracy of using a rate period's probable maximum investment amount as ComEd's investment throughout the rate period. (*Id.; see* Hemphill, Mar. 7 Tr. at 120-121, 149). IIEC believes the Commission approval of ComEd's investment maximum in a year as its investment for the entire rate period would over-state ComEd's rate base. IIEC's second rate base issue is ComEd's proposal to ignore the change in its accumulated deferred income taxes ("ADIT") over the relevant rate period. IIEC notes ADIT is the third largest component of ComEd's rate base, and its recognition would reduce ComEd's proposed rate base amount. (Gorman, IIEC Ex. 2.,0 at 11:255-257; Effron, AG-AARP Ex. 4.0 at 9:193). Ignoring that component of rate base also would over-state ComEd's actual investment. IIEC's third rate base adjustment concerns ComEd's inaccurate measurement of its cash working capital requirement.

IIEC argues approval of a rate base amount that includes investment value that is not actually used to provide ComEd's regulated services during the relevant formula rate period would exceed the Commission's authority under the PUA. (*See* 220 ILCS 5/9-211). IIEC points out that each of these challenged aspects of ComEd's rate base proposal has the effect of inflating ComEd's rate base. IIEC asserts ComEd's proposed rate base should be modified to eliminate (through more accurate determinations) investment amounts that are not actually used to provide service to ComEd's ratepayers.

C. Potentially Contested Issues

1. Average Year or End of Year Rate Base (see also VIII.C.1)

a. ComEd's Proposal and Arguments

IIEC says that, in the direct testimony of ComEd witness Kathryn Houtsma, ComEd proposes to use its FERC Form 1 report of end-of-year investment as the basis for calculating its rate base for Illinois delivery service rates for the rate year. (Houtsma, ComEd Ex. 2.0 at 13:259-268). IIEC witness Mr. Gorman, as well as other parties' experts, opposed ComEd's proposed use of the likely highest investment amount in a rate period as the rate base for the entire period and the foundation of formula rates for that period. (*See* Gorman, IIEC Ex. 1.0-C at 24:538-555; Smith, CUB Ex. 2.0 at 59:1352-1363; Effron, AG-AARP Ex. 2.0 at 19:412-417; Brosch, AG-AARP Ex. 1.0 at 9-11:196-224).

According to IIEC, in her rebuttal, Ms. Houtsma recognizes the intervenor proposals for the use of an average year rate base instead of ComEd's year-end rate base. However, IIEC notes she incorrectly described all parties' opposition to her proposal as being related only to reconciliation proceedings. (Houtsma, ComEd Ex. 12.0 at 32:692-702, 32:714). IIEC's Mr. Gorman proposed use of an average year calculation of rate base in all formula rate proceedings, including this one. (Gorman, IIEC Ex. 2.0 at 3:56-59). (Other witnesses did examine rate base issues in the context of discussions of the reconciliation process.) Ms. Houtsma defends ComEd's use of a rate base that will systematically increase ComEd's revenues by overstating its investment dedicated to providing regulated service. (Gorman, IIEC Ex. 1.0-C at 5-6:127-138; Brosch, AG-AARP Ex. 1.0 at 9-11:196-224).

IIEC points out that in response to other parties' objections, Ms. Houtsma makes several arguments defending ComEd's use of its year-end investment as the investment amount for the rate year. IIEC finds Ms. Houtsma contends: (i) the year-end amount is required by Section 16-108.5(c)(6); (ii) an average year rate base is not explicitly mentioned in Section 16-108.5; (iii) the reconciliation calculation must be identical to ComEd's proposed year end rate base calculation in this initial case; (iv) the year-end amount is the result of using FERC Form 1 data; and (v) the year-end amount is consistent with traditional ratemaking. At other points, ComEd also argued that intervenor arguments were based on test year concepts that do not apply in this case. As discussed below, each of ComEd's arguments is without substantive or legal merit.

b. IIEC's Recommendations for Determination of Rate Base

IIEC contends that, as a general matter, the Commission's determination of ComEd's revenue requirement should seek to approximate, as closely as practicable, ComEd's actual costs for the rate period at issue.

> The formula rate statute requires rates to be just and reasonable. Therefore, a more accurate measurement of ComEd's actual cost of service during the initial rate period and subsequent rate years is needed.
> (Gorman, IIEC Ex. 2.0 at 4:99-101).

As noted, that position represents a consensus among the parties. (*See, e.g.,*Gorman, IIEC Ex. 2.0 at 11:259, 3:64; Effron, AG-AARP Ex. 2.0 at 24:308-320; Hemphill, ComEd Ex. 20.0 at 8:162 and Mar 7 Tr. at 126, 138, 140).

IIEC believes the issue on which application of that principle is most consequential is the determination of ComEd's rate base. Because the Commission must determine ComEd's prudently incurred and reasonable costs (including its capital costs) for a specific period -- and not for the last day of the rate period -- an average year rate base more accurately reflects the actual rate base investment during the rate period. IIEC asserts that using the reported year-end amount, as ComEd proposes, would overstate the investment ComEd actually has in service during the rate period. (*See,* Gorman, IIEC Ex. 1.0-C at 25:545-555 and IIEC Ex. 2.0 at 5-6:123-138).

IIEC proposes the Commission use an average year rate base, calculated using the January 1 and December 31 investment amounts shown on the relevant ComEd FERC Form 1. Use of the average year rate base provides a more accurate measurement of ComEd's actual capital cost of service than is provided by ComEd's use of the form's year-end investment amount. That cost input for formula rates is best measured by using an average year rate base. (*Id.*).

> Plant in-service can change with capital additions and retirements throughout the year. As a result, ComEd's net plant in the beginning of the year will change by year-end. Therefore, ComEd's annual operating income should be based on its <u>actual balance of invested utility plant</u> and equipment during the year. (Gorman, IIEC Ex. 1.0-C at 24:545-554).

c. ComEd's Legal Arguments Lack a Basis in Section 16-108.5

IIEC points out that Section 16-108.5(c) defines, as the over-arching objective of formula rates, that "the formula rate approved by the Commission shall . . . (1) provide for the recovery of the utility's <u>actual costs</u> of delivery services that are <u>prudently incurred</u> and <u>reasonable</u> in amount consistent with Commission practice and law." (220 ILCS 5/16-108.5(c); *also* 220 ILCS 5/16-108.5(d) ("intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year . . . with . . . actual cost information for the applicable calendar year . . . .") And though ComEd's FERC Form 1 is identified as the <u>starting</u> point for formula rate cost inputs, IIEC points out that Section 16-108.5(c) is equally clear that the mere presence of a number in that form has no determinative significance. "Nothing in this Section is intended to allow costs that are not otherwise recoverable to be recoverable by virtue of inclusion in FERC Form 1." (220 ILCS 5/16-108.5(c)).

IIEC notes that Section 16-108.5(c) consistently requires that a Participating Utility determine its initial formula rates (as in this proceeding) using "final data <u>based</u> <u>on</u> its most recently filed FERC Form 1," plus cost projections for the following rate year. (*Id.*). Similarly, formula rate cost inputs in subsequent reconciliation proceedings must be "<u>based</u> <u>on</u> final historical data reflected in the utility's most recently filed annual FERC Form 1," plus projected costs for the following rate period. (220 ILCS 5/16-108.5(d)(1)).

IIEC finds, more importantly, in both initial and reconciliation formula rate proceedings, all proposed cost inputs (whether or not shown on a FERC Form 1) are expressly subject to the Commission's Article IX authority (and duty) to ensure that only prudently incurred, reasonable costs are included in approved rates. (220 ILCS 5/16-108.5(c); 220 ILCS 5/16-108.5(d)).

> Such review shall be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act. (220 ILCS 5/16-108.5(c) (*re* required review of initial filing)).
>
> The Commission shall apply the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, in the hearing as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act. (220 ILCS 5/16-108.5(d) (*re* reconciliation filings)).

Contrary to the argument ComEd makes in defense of its proposal to use year-end rate base amounts, it is apparent that neither average year nor year-end rate base amounts are expressly <u>required</u> by Section 16-108.5. IIEC concedes it is true, as Ms. Houtsma argues, that "the statute makes no mention of the use of average data in the determination of rate base for the reconciliation." (Houtsma, ComEd Ex. 12.0 at 33:725-726). However, IIEC notes it is equally true that the statute makes no mention of “year-end” data in the determination of rate base, for either initial or reconciliation formula rates.

IIEC finds the statutory requirement for costs “based on” the utility’s FERC Form 1 is best satisfied by IIEC’s proposed average year rate base.

> [Ms. Houtsma’s] apparent belief that FERC Form 1 data would not contain the information necessary to calculate an average year rate base also is in error. Indeed, FERC Form 1 data for balance sheet components, the data source necessary to construct the average year rate base, includes a column for both end-of-year and beginning-of-year amounts. Hence, an average year rate base can be calculated from any particular year’s FERC Form 1, complying with the directives that a participating utility’s ratemaking cost data be based on its most recently filed FERC Form 1. (Gorman, IIEC Ex. 2.0 at 3:68-75).

IIEC argues the General Assembly did not intend that only numbers appearing on a FERC Form 1 be used in formula rate calculations. (220 ILCS 5/16-108.5(c)). Had that been the intent, IIEC points out, the Commission would not have been given -- and would be unable to perform -- the explicitly imposed duty of Article IX review. Instead, IIEC notes, the statute requires only that the amounts used to set rates be “based on” or “reflect” FERC Form 1 cost data and that the costs have been subjected to the Commission’s Article IX review.

IIEC says that, in response to criticisms from other parties that allude to the Commission’s established policies and practices in test year rate cases, ComEd’s lead witness, Ross Hemphill, asserted forcefully that test year concepts have no relevance in this formula ratemaking context.

> The ALJs and Commission should keep in mind that test year rules have little or no remaining application in the annual formula ratemaking world. The formula rate is fully reconciled to actual reasonable and prudently incurred costs. That reconciliation also recognizes the time value of money. (Hemphill, ComEd Ex. 11.0 at 6:115-118).

Despite that declaration, IIEC points out that Ms. Houtsma uses a test year analogy to justify ComEd’s rate base proposal. Ms. Houtsma argues that the use of a year-end rate base is justified because it is consistent with how ComEd has employed a historical rate base with pro forma plant additions in its more recent rate cases. (Houtsma, ComEd Ex. 12.0 at 33-34:728-754). Mr. Hemphill re-interprets her argument to liken formula rates to rates based on a historical test, in that the “collections under rates will not begin until well after the bulk of the costs are incurred.” (Hemphill, ComEd Ex. 20.0 at 14:292-295). However, the Section 16-108.5 reconciliation process makes that comparison irrelevant. As ComEd’s Mr. Hemphill explained:

> Under formula rates, the revenue requirement is for a particular calendar year, and <u>*only*</u> that year, and it is independently established for each year. (Hemphill, ComEd Ex. 20.0 at 5:105-106).

IIEC notes that under the governing statutory process, ComEd recovers its actual costs, regardless of when collections begin, because "forecast investment data is used to develop initial revenue requirements, which are fully reconciled, after the fact, to a revenue requirement based on the actual cost data." (*Id.* at 6:116-118). And that reconciliation includes compensation for the delay in cost recovery. (Hemphill, 7 Mar. Tr. at 92-93).

IIEC asserts, however, even if one sets aside the Commission's test year rules, the statutory prudence and reasonableness standards remain a part of the Commission's Article IX review, and -- as explicitly required by the formula rate statute -- those standards must be applied in this proceeding. As IIEC witness Gorman explained:

> In this context, the reasonableness of proposed costs can depend on concepts used in test year analyses, including whether projected costs used for setting rates are speculative (and therefore unjust or unreasonable) or are more in the nature of known and measurable costs.
> (Gorman, IIEC Ex. 2.0 at 4-5:101-5:105).

IIEC argues that since the formula rate statute does not expressly require the use of either average-year or year-end amounts, the Commission's determination of ComEd's actual, prudently incurred, and reasonable investment, in its Article IX review is the decisive factor. IIEC asserts the Commission's deliberations should involve issues or approaches common to its Article IX reviews of test year rate case proposals. IIEC finds such issues or Commission practices utilized in making Article IX determinations are not inapplicable to formula rate proceedings simply because they may have been codified in the Commission's test year rules.

IIEC notes that the Commission's Article IX determinations must be based on the substantive record evidence in this case. As shown below, that evidence supports IIEC's recommended modifications of ComEd's proposed rate base computation.

d. The Substantive Record Evidence Contradicts ComEd's Arguments

IIEC argues, regarding the rate base to be used in setting ComEd's formula rates, the record in this case establishes that an average rate base is the proper measure of the ComEd investment properly used in setting its formula rates. IIEC points out that fact is confirmed by ComEd's own testimony.

> **Q** Mr. Hemphill, referring you to the FERC Form 1 for any given year, does the balance of plant in service as of the end of the

> year accurately represent the balance of plant that was actually in service for the entire year?
>
> **A** No, it is the plant that was in service at the end of that year. (Hemphill, Mar. 7 Tr. at 65 (emphasis added)).

IIEC states that in order to justify ComEd's proposal to use a year-end figure, thus yielding a larger rate base, ComEd abandons any quest for the "value of . . . investment . . . both prudently incurred and used and useful in providing service" (220 ILCS 5/9-211) and ignores the statutory ceiling on rate base investment the Commission has authority to approve. Instead, ComEd offers the Commission its proposal to capture ComEd's "activity" -- rather than its investment providing service -- for a rate period. (Hemphill, ComEd Ex. 20.0 at 12:251-252). IIEC notes that utilities do not earn, and have never earned, on their activity -- only on the lawful investment devoted to service. More importantly, IIEC points out the statutory imperative of formula rate inputs is not to capture ComEd's activity in that year, but ComEd's lawful, actual costs of providing service in the rate year. (220 ILCS 5/16-108.5(c)). IIEC argues that the record shows, whether the ceiling on lawfully approved rate base investment is defined by "the value of such investment which is both prudently incurred and used and useful in providing service" (220 ILCS 5/9-211) or by "the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law" (220 ILCS 5/16-108.5(c)), ComEd's use of the highest level of investment in a rate year would exceed what is lawfully allowed for rate base. (*See, e.g.*, Gorman, IIEC. Ex. 1.0-C at 24:545-555; Effron, AG-AARP Ex. 4.0 at 12-13:274-278; Smith, CUB Ex. 3.0 at 40-41:875-893).

IIEC finds the record also undermines ComEd's argument that the year-end amount is appropriate because its return is collected after the end of the rate year. IIEC notes that the same ComEd witness making this argument also confirms that the formula rates compensate ComEd for the time value of money. (Hemphill, Mar. 7 Tr. at 92-93). Thus, the formula rate statute has affirmatively eliminated any need for artificial increases to rate base, even considering any delay in cost recovery.

4. Cash Working Capital Issues

IIEC says that ComEd argues that its cash working capital ("CWC") requirement is based on a proper lead/lag study "similar" to the one approved by the Commission in ComEd's last rate case, ComEd Docket 10-0467. ComEd observes that it has made three changes to the study in this case. According to ComEd, the first change was ordered by the Commission in ComEd Docket 10-0467, and the second and third changes were designed to make the lags and leads for certain pass-through tax items more accurate.

IIEC has identified flaws in the ComEd lead/lag study associated with the calculation of the collection lag (32.34 days) used by the Company to calculate its overall revenue lag of 51.25 days. IIEC supports further study and analysis of ComEd's approach to calculate its CWC requirement and in the meantime, supports AG/AARP witness Brosch's proposal for a 46.08 day revenue lag. IIEC also pointed out the inappropriateness of changing the revenue lag assigned to energy assistance charges/renewable energy charges (EAC/REC) and gross receipts taxes and municipal taxes (GRT and MUT) from zero-days approved in ComEd Docket 10-0467 to 51.25 days in this case.

a) Revenue Collections Lag

IIEC argues that ComEd's revenue lag of 51.25 days is overstated, and as a result, its CWC calculation is overstated. IIEC finds that a revenue lag of 35 to 40 days would be more appropriate. (Gorman, IIEC Ex. 1.0-C at 28:650-653). IIEC believes one of the primary compo nents of the revenue lag is the collection lag. ComEd has proposed a collection lag of 32.34 days.

IIEC argues ComEd's calculation of revenue lag fails to give proper credence to the fact that ComEd's tariffs give customers 21 days to make remittance on their bills before they are considered late. (*Id*. at 28:653-655). Given such tariff provisions, it is reasonable to expect that the collection lag component of the revenue lag would be less than the 32.34 days reflected in ComEd's CWC calculation. IIEC notes that ComEd's calculation of CWC requirement reflects significant late payments based on accepting the assumption that customers as a whole pay their bills late (after the 21 day remittance period). (*Id*. at 29:657-658). IIEC argues that is not a reasonable assumption, and ComEd does not provide the type of evidence multiple experts testified could test its assumption. IIEC asserts ComEd fails to present any information that demonstrates that the size and timing of customers' late payments support its assumption.

> ComEd does not actually measure how long it takes to collect revenues from its customers. Instead the Company looks to a breakdown of its month-end Accounts Receivable balances by customer class and assigns, without any supporting analysis, . . . arbitrarily assumed revenue collection dates to each grouping of aged receivable balances . . . .
> (Brosch, AG-AARP Ex. 1.0 at 23:492).

IIEC notes the aged account analysis ComEd uses to support its lag calculation included uncollectibles. (Hentgten, ComEd Ex. 16.0 at 6:108-109). IIEC argues uncollectibles should not be included in the determination of a collection lag because they represent revenue that ComEd will not collect as customer payments. (Gorman, IIEC Ex. 2.0 at 15:331-333; Smith, Cub Ex. 1.0 at 31-32:688-701; AG-AARP Ex. 1.0 at 24-25:513-528). IIEC finds the inclusion of the uncollectible revenues causes a collection lag longer than the 21 day period ComEd gives customers to remit their bill payment. (*Id*. at 16:335-338).

ComEd suggests that any adjustment to the collection lag was inappropriate because all accounts are not paid within the 21 days. (*Id*. at 347-349). ComEd also argued that it could not identify which accounts would eventually be uncollectible. (*Id*. at 339-341)**.**

With regard to ComEd's first argument, IIEC agrees it is true that not all customers pay within the 21-day remittance period. However, IIEC asserts the collection lag of 32.34 days proposed by ComEd asserts that, on average, all of ComEd's customers pay after 21 days -- specifically, that all customers pay more than 11 days after the 21 day remittance period expires. (*Id*. at 15:349-354). IIEC notes that this is simply not a realistic assumption, and ComEd has not provided empirical evidence that this result reflects actual customer payment behavior and is reasonable. As a result, ComEd fails to support its overstated collection lag.

As to ComEd's second argument, IIEC believes an inability to identify with certainty the specific customer accounts that will not pay their bills and become uncollectible does not mean that ComEd should reflect all uncollectibles in the analysis. In any case, it is not necessary for ComEd to identify the individual accounts that will become uncollectible. Since ComEd does not identify the specific accounts that will pay at the times assumed for its analysis, ComEd can make similarly approximate the amount of uncollectibles for the purposes of its cash working capital analysis. (*Id.* at 15:339-343). IIEC believes that ComEd's refusal to remove the effect of uncollectibles from the analysis is equivalent to assuming that there will be zero uncollectible accounts. (*Id*. at 15:343-346). IIEC argues that such an assumption is not reasonable, and it overstates the collection lag.

IIEC argues that, given the significant flaws in ComEd's calculation of the collection lag and the absence of an adequate explanation for a collection lag more than 11 days greater than the 21 day remittance period prescribed by ComEd's tariffs, the Commission should order further investigation of ComEd's approach. In the interim, IIEC asserts the Commission should adopt the position advocated by AG/AARP witness Brosch, who has adjusted ComEd's collection lag to address the uncollectible issue and recommends an overall revenue lag of 46.08 days. (Brosch, AG/AARP Ex. 1.0 at 28-29:610-619).

b) Pass-Through Taxes

IIEC proposed an adjustment to ComEd's cash working capital calculation to change the revenue lag days for EAC/REC charge collections and the revenue lag days for GRT/MUT taxes from 51.25 days to zero days, consistent with the commission's ruling in the last ComEd rate case, Docket 10-0467. IIIEC says the revenue lag for these pass-through taxes should be zero days. IIEC agrees, as ComEd has argued, that taxes are a part of customer bills remitted to ComEd. (Gorman, IIEC Ex. 1.0-C at 27:606-609)**.** However, IIEC believes ComEd fails to give proper effect to the fact that the charges and taxes in question are payable, by ComEd, after the revenues have been collected. Specifically, EAC/REC charges are payable, by ComEd, the 20th day of the month following the month in which they are collected. (Hengtgen, ComEd Ex. 8.0 at 11:211-215). The GRT/MUT taxes are payable on or before the last day of the month following the month in which they are collected or required to be collected. (*Id.* at 12:218-222).

IIEC argues that, because these taxes and charges are not due to be paid by ComEd until after ComEd has collected revenues to pay them, assignment of any revenue lag to such taxes is inappropriate. (Gorman, IIEC Ex. 1.0-C at 27:629-632). Moreover, IIEC finds prepayment of the taxes and charges could be considered imprudent, meaning the resulting costs were not prudently incurred and are unreasonable. Indeed, these taxes and charges were assigned a zero-day lag in ComEd's last rate case (Dkt. 10-0467), and the recent Peoples/North Shore cases

(Dkts. 11-0280 and 11-0281, Cons.), (Gorman, IIEC Ex. 2.0 at 18:406-410). IIEC contends the Commission should do the same in this case.

While ComEd has acknowledged that these taxes and charges are due after revenues for payment of the taxes have been collected from ratepayers, ComEd argues that it has historically remitted these taxes and charges based on billed revenues instead of collected revenues. (*Id*. at 16:372-375). Thus, ComEd proposes that ratepayers be required to pay more for electric service because ComEd has volunteered to remit these taxes and charges before it is actually required to do so. IIEC argues ComEd's payment of these taxes on the basis of billed revenues instead of collected revenues, increases its cash working capital needs and unnecessarily increases its cost of electric delivery service. (*Id*. at 15-17:351-384).

ComEd has suggested that if it changes from a billed revenue methodology to a revenues collected methodology, municipalities would miss monthly payments. (*Id*. at 17:386-390). IIEC notes that while it is true that a single monthly payment would be delayed (not missed) in the first year of any change the affected governmental units would still receive all of the taxes they were due. (Gorman, Mar. 12 Tr. at 767-769).

IIEC argues that ComEd's customers should not be required to pay the increased costs associated with increased cash working capital requirements, caused by ComEd's decision to voluntarily pay the subject taxes and charges before they are due. Therefore IIEC believes, EAC/REC charges and GRT/MUT taxes should be assigned zero lag days as they were in ComEd's last rate case and the most recent Peoples Gas/North Shore Gas rate cases, and Schedule FRB-1 should be modified accordingly. (Gorman, IIEC Ex. 1.0-C at 28:638-647).

5. Accumulated Deferred Income Taxes

a) 2011 Plant Additions

(1) ComEd Proposal

IIEC says ComEd has proposed to determine its formula rates using a rate base that includes projected plant additions and the build-up in accumulated depreciation in the year following the rate year, but not the contemporaneous build-up in Accumulated Deferred Income Taxes (ADIT). (Gorman, IIEC Ex. 1.0-C at 25:577-584). ComEd argues that recognition of ADIT is (a) barred by the formula rate statute, Section 16-108.5 and (b) unnecessary because the formula rate reconciliation process will remedy any error in the projected costs used to set rates for the rate period. (Fruehe, ComEd Ex. 13.0 at 8:160-166)

IIEC proposes that the rate base used to set rates also incorporate a projection of ADIT for the period of the ComEd plant additions. (*See* Gorman, IIEC Ex. 1.0-C at 26:577-597). IIEC notes ADIT is the third largest component of ComEd's rate base. (Gorman, IIEC Ex. 2.0 at 11:255-256). IIEC argues ADIT, if not other components, in addition, must be recognized if rate base is to be accurately determined and later reconciliation credits or charges minimized. (*See*, Gorman, IIEC Ex. 1.0-C at 23:520-523 and IIEC Ex. 2.0 at 10-12:223-276).

IIEC asserts ComEd's arguments -- resolution in reconciliation and statutory direction -- are in error, both as a matter of law and as a factual issue.

IIEC notes that Section 16-108.5 does not expressly bar the Commission's consideration of ADIT in its determination of ComEd's rate base. (*See* 220 ILCS 5/16-108.5(c) and (d)). IIEC explains the Commission is expressly charged with implementing that provision to achieve the over-arching objective of the formula rates in this initial proceeding, rates that "provide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." (220 ILCS 5/16-108.5(c). The Commission has effectively the same charge in any subsequent reconciliation proceedings -- to reconcile the revenue requirement based on projected rate year costs "with . . . actual cost information for the applicable calendar year . . . ." (220 ILCS 5/16-108.5(d)).

IIEC notes that the consensus of the parties in this case is that, consistent with Commission-observed principles of ratemaking and to spare ratepayers and utilities the "cost of larger reconciliation adjustments," the Commission should avoid unnecessarily large reconciliation adjustments. (Hemphill, ComEd Ex. 20.0 at 8:165-168). That approach requires accurate projections of rate year costs, to supplement FERC Form 1 data from the prior calendar year. IIEC finds these tasks are expressly subject to the Commission's Article IX authority (and duty) to ensure that only prudently incurred, reasonable costs are included in approved rates. (220 ILCS 5/16-108.5(c); 220 ILCS 5/16-108.5(d)). IIEC asserts the Commission's affirmatively imposed duty to conduct an Article IX review cannot be performed if, as ComEd argues, the Commission cannot consider contemporaneous offsets (measuring in the hundreds of millions of dollars) to projected costs. (*See* Effron, AG-AARP Ex. 2.0 at 16:341-342). IIEC argues the Commission review must apply "the same evidentiary standards . . . the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act. (220 ILCS 5/16-108.5(c) and (d)).

IIEC notes that in recent decisions, the Commission and reviewing courts have recognized that such rate determinations under Article IX require the Commission to take account of the contemporaneous build-up of offsets to plant additions -- *viz*., accumulated depreciation and the "companion" adjustment ADIT -- to accurately measure rate base, so that PUA Section 9-211 is not violated. (*Re Central Illinois Light Co, et al.*, Dkt. 09-0306 (cons.), Order on Rehearing, Nov. 4, 2010 at 49 (re accumulated depreciation and ADIT); *Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 405 Ill. App. 3d 389 at 405 (2nd Dist. 2010) (re-accumulated depreciation); *Ameren Illinois Company v. Ill. Commerce Comm'n*, Nos. 4-10-0962, 4-10-0976, 4-11-0075 cons. (Ill. App. Ct. 4th Dist. Jan. 10, 2012) (re accumulated depreciation and ADIT). Since this "companion" adjustment is a legally required part of "Commission practice and law" (220 ILCS 5/16-108.5(c), the Commission must consider this rate base component as well as accumulated depreciation. IIEC asserts that only in this manner can the Commission make a lawful determination under Section 16-108.5. (220 ILCS 5/16-108.5(c)(1)).

IIEC observes ComEd also argues that recognizing the effect of ADIT on its projected rate base and capital costs is unnecessary, because any deviation from its actual costs will be rectified in reconciliation charges. (Fruehe, ComEd Ex. 22.0 at 6:130-7:149). IIEC finds that ComEd's argument is essentially meaningless, since <u>all</u> deviations from ComEd's actual costs of service, no matter how unreasonable, should be caught in later reconciliations. IIEC argues that ComEd's interpretation of the statute to preclude consideration of costs not specifically mentioned, would support ignoring entirely the required Article IX review of proposed costs. IIEC finds that course however, would effectively excise from the statute clear mandates to the Commission -- to determine the amount of ComEd's prudently incurred, reasonable costs used to provide service and to allow only such costs in setting ComEd's rates. (220 ILCS 5/9-201(c); Hemphill, Mar. 7 Tr. at 142 ("ComEd is entitled to earn only on the investment used to provide service"). In any case IIEC points out, as ComEd's lead witness Mr. Hemphill agreed, the statutory promise of a later reconciliation does not allow the Commission to approve a rate base or a rate that is not prudent, just and reasonable. (Hemphill, Mar. 7 Tr. at 141).

IIEC finds there is no inherent conflict here between the provisions of Section 16-108.5 and the requirements of Article IX. Further IIEC finds, there is no express prohibition on the Commission's consideration of revenue requirement components not specifically mentioned in Section 16-108.5. IIEC asserts the Commission's required Article IX review of the components of ComEd's proposed capital costs must take account of both accumulated depreciation and ADIT, as consistent with Commission practice and required by Section 9-211.

V. OPERATING EXPENSES

A. Overview

IIEC has not recommended any specific adjustment to ComEd's proposed operating expenses. However, IIEC has recommended that the Commission set a pre-determined level of regulatory expense and affiliate charges expense that would cause the Commission to exercise its authority to initiate a formal investigation of the annual reconciliation filing made by ComEd under Section 16-108.5(d). IIEC also recommends a distinct limit on recovery of incentive compensation expense. IIEC addresses this issue in Section VIII.B.2. below.

VI. RATE OF RETURN

A. Overview, Including Overall Cost of Capital

IIEC notes Section 16-108.5 requires that the formula rate ". . . reflect the utility's actual capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law." (220 ILCS 5/16-108.5(c)(2)). In addition, IIEC notes the formula rate must also include a return on common equity equal to the sum of: the average of monthly yields on 30-year Treasury Bonds plus 580 basis points. (220 ILCS 5/16-108.5(c)(3)(A) and (B)).

B. Capital Structure

4. Common Equity Ratio/Cap Limit

IIEC points out that the Commission has the obligation under Section 16-108.5 to determine the reasonableness and prudence of the utility's actual capital structure for each applicable rate period. (220 ILCS 5/16-108.5(c)). The Commission has only 45 days to review the annual filing made by the Company and to determine whether it will conduct a hearing. (220 ILCS 5/16-108.5(d)). IIEC believes the Commission should implement procedures to ensure that, in evaluating the Company's capital structure, the capital structure does not contain an excessive amount of common equity.

IIEC asserts a capital structure should be balanced with appropriate amounts of debt and equity to minimize the overall cost of capital. (Gorman, IIEC Ex. 1.0-C at 30:680-689). Therefore, IIEC recommends that the Commission order immediately that the formula rate reflect a common equity ratio limit of 55% to ensure that ComEd's overall cost of capital reflects reasonable and prudent management of its capital structure. (*Id*. at 30:692-695). Such a limit is already included in the ComEd formula rate approved by the Federal Energy Regulatory Commission for ComEd's transmission service. (*Id*. at 31:697-699).

Specifically, IIEC proposes that Schedule FRD-1 - Cost of Capital Computation, Line 7 - Equity as a Percentage of Total Capital - should be limited to not more than 55%. To the extent the Line 7 percentage figure is less than 55%, the calculation shown on that line would be used to develop the cost of capital for the applicable year. If the calculation shown on Line 7, Column B shows a common equity ratio greater than 55%, then the difference should be added to the percentage of long-term debt shown on Line 8 under Column C of Schedule FRD-1. (Gorman, Ex. 1.0-C at 31:702-716).

If the Commission adopts the Staff's recommendation for an immediate determination of a return on common equity ratio equal to 46.12% (Phipps, Staff Ex. 7.01), IIEC's recommended adjustment would not apply. If in a subsequent filing under Section 16-108.5 ComEd's actual capital structure contains a common equity component of 60%, IIEC's cap would apply and the difference between 55% and 60% would be attributed to long term debt.

5. Subsequent Procedure/Process Re: Capital Structure Issues

IIEC observes that in the rebuttal stage of this case, ComEd witnesses suggested that IIEC's recommendation on the equity cap "should be deferred and addressed in discussions outside of this proceeding, perhaps contemporaneously with the discussion with Staff regarding capital structure." (Vogt, ComEd Ex. 15.0 at 2:42-43; *see also,* 12:253-258). IIEC agrees that there should be a separate analysis or study done by the Commission, in the context of a formal -- not informal -- proceeding, to determine an appropriate common equity ratio cap for ComEd on a going-forward basis. However, IIEC argues that when the Commission conducts its review, it should reflect the reduced operating risk realized by ComEd as a result of the existence of the formula rate, as well as all other factors relevant to establishing an appropriate level of common equity for its capital structure. The ceiling so determined should apply to the pertinent rate year in future formula rate filings.

In the interim, IIEC believes the Commission should include a common equity cap of 55% as proposed by IIEC pending the results of such a proceeding. IIEC finds the imposition of such a cap is (i) consistent with the formula rate approved by FERC for ComEd and (ii) a reasonable interim ceiling, pending the completion of the Commission's review and analysis to establish the appropriate cap. IIEC believes the interim cap will help ensure that ratepayers do not pay rates based on an imprudent or unreasonable percentage of common equity.

VIII. ADDITIONAL FORMULA/TARIFF ISSUES

A. Tariff Issues

According to IIEC, ComEd has proposed a very detailed tariff – Rate DSPP–Delivery Service Pricing and Performance -- to implement the initial and reconciliation phases of the formula rate setting regime defined by Section 16-108.5 of the Public Utilities Act ("PUA"). Much of ComEd's proposed tariff consists of detail that is traditionally included in supporting workpapers for the quantification or justification of factors used in setting rates. IIEC believes the proposed tariff exceeds the level of detail required by the functional tests defined in Section 16-108.5. IIEC suggests the Commission, therefore, may modify the tariff to enhance its understandability, to facilitate implementation of changes reflecting the Commission's rate determinations, and to permit meaningful regulatory review by the Commission and affected stakeholders.

1. Separate Statement of Earnings Collar Effects

IIEC opines, that under section 16-108.5(c)(5), ComEd's earnings are permitted to vary from the authorized level defined by the statutory computation, as long as the variation does not exceed 50 basis points (0.5%) in either direction. (220 ILCS 5/16-108.5(c)(5)). However, IIEC points out that under ComEd's proposed tariff treatment of the earnings collar mechanism, the revenues or earnings ComEd gained or lost through operation of the collar are not disclosed.

IIEC notes that even in the tariff spreadsheets, ComEd makes the calculation required to compute any adjustment for earnings outside the collar in a way that does not reveal the dollar impact of the increased earnings opportunity that ComEd enjoys under the formula rate. (Fruehe, ComEd Ex. 22.1, Sch. FR A-3). Moreover, IIEC points out that even when there is a credit or charge for earnings outside the collar, the dollar effect of the permitted earnings latitude remains hidden, as only the excess (or deficiency) is clearly shown. (Fruehe, ComEd Ex. 22.1, Sch. FR A-3). IIEC notes that on customer bills, even less information would be shown, since the excess (or deficiency), if one exists, is subsumed in a single larger reconciliation adjustment that is itself combined with the revenue requirement based on new FERC Form 1 data to compute the net (total) revenue requirement on which formula rates are set. (Fruehe, ComEd Ex. 22.1, Sch. FR A-1-REC, Sch. FR A-1).

IIEC proposes that the effects of the earnings collar be identified separately on Schedule FR A-1. Clearly identifying the effect of the various earnings collar calculation components in the revenue requirement calculation would enhance the transparency of the formula rate determinations and help the Commission gauge whether the formula rate is consistently yielding rates that produce excessive or deficient earnings, as well as show the magnitude of increased (or decreased) revenues and earnings within the collar. IIEC argues that moving that information directly into Schedule FR A-1 makes it a more transparent component of the formula rate and properly separates it from the reconciliation Schedule FR A-1-REC component of Rate DSPP. (Gorman, IIEC Ex. 1.0-C at 15:324-332).

> Unless the Commission accepts IIEC's recommendation for a simpler tariff, the role of each calculation should be presented explicitly in the development of the overall revenue requirement used to develop the formula rates, in order to provide a transparent development of the rates customers must pay. (Gorman, IIEC Ex. 2.0 at 9:210-214).

IIEC points out that clarity of communication with ratepayers, and with others interested in the effect of the elements of the formula used to set rates, is easily accomplished. The reconciliation adjustment (Sch. FR A-1, line 24) can be disaggregated to show the earnings amount permitted by the collar, the excess (or deficiency) for which an adjustment is required, and the separate effect of inaccuracies in the cost projections that supplemented applicable FERC Form 1 data. The corresponding items on the reconciliation spreadsheet should be modified similarly, except that the revenue requirements based on new FERC Form 1 data (which are irrelevant to the reconciliation) are excluded.

IIEC also recommends a separate calculation of the interest expense on the earnings collar component. (Gorman, IIEC Ex. 1.0-C at 20:459-462). IIEC finds "ComEd's proposal obscures whether and how each calculation affects rates in a particular rate period and does not provide transparency for customers or the Commission." (Gorman, IIEC Ex. 2.0 at 9:214-216).

ComEd witness Houtsma states, in opposition to IIEC's proposal to break out the effects of the earnings collar, that "the primary reason it is combined on the first page with the reconciliation amount is to allow for a combined interest calculation." (Houtsma, ComEd Ex. 21.0 at 30:659-662). Ms. Houtsma also opines that there is no benefit to be gained from IIEC's proposal for accessible detail about this component of the formula process.

IIEC says that ComEd complains that "[u]nbundling the components as Mr. Gorman would suggest would unduly complicate the interest calculation . . . ." (*Id.*). IIEC notes that, with respect to a tariff containing dozens of pages and hundreds of lines of revenue requirement computations, that argument cannot be seen as a serious objection. Moreover, merely disaggregating and displaying the effects of the earnings collar is unlikely to complicate a related calculation.

IIEC argues the total effect of the earnings collar cannot be ascertained without separate calculations of the dollar variance within the collar and the interest cost on any credit or charge for earnings outside the collar. IIEC notes that interest cost must be computed, separately from the interest on other reconciliation amounts, and be reported.

If, in fact, the computerized calculation of which ComEd complains is affected by displaying the full (including interest) effect of the earnings collar, it is a simple matter to combine (or recombine) the pieces for the computerized interest calculation. IIEC notes that the independent issue of increased transparency through revealing the effects of the earnings collar mechanism is not an impediment to ComEd's computerized calculations of revenue requirement.

To recover some of the clarity that is missing from ComEd's proposed tariff, IIEC recommends that the Commission order that the earnings collar calculation not be buried in the reconciliation component of the revenue requirement. (*See*, Gorman, IIEC Ex. 1.0-C at 14-15:320-332, 20-23:444-516 and IIEC Ex. 2.0 at 9-10:200-220). IIEC believes separately stating that calculation and the results of the collar application would make it more transparent, and help the Commission gauge whether or not the formula rate is consistently setting rates that produce excessive or deficient earnings.

2. Calculation of Increases for Three-Year Report

IIEC reports that under Section 16-108.5(g), ComEd is required to report to the Commission by July 31, 2014 its average annual rate increases for residential customers (on a per kWh basis) over the previous three years (June 1, 2011 to May 31, 2014. (220 ILCS 5/16-108.5(g); Gorman, IIEC Ex. 1.0-C at 12:252-265). An annual rate of increase in excess of 2.5% per year would disqualify ComEd from continued use of the formula rate mechanism. (220 ILCS 5/16-108.5(g)).

According to IIEC, ComEd signaled that it has a preference (and presumably an economic incentive) for formula rates by electing to become a Participating Utility. (Hemphill, ComEd Ex. 1.0 at 1:15-16). The required determination and report of the rate of increase in per kWh charges can be directly affected by the starting point for the year-to-year comparisons. Yet, as IIEC points out, ComEd has not advised the Commission of the starting point it plans to use in computing that performance benchmark. IIEC proposes that the Commission determine and advise all parties of the appropriate starting point for that three-year assessment. IIEC proposes specifically that the starting point be the rates ordered in the Commission's last ComEd rate order, adjusted for the cost of equity, as determined by the current statutory formula. (220 ILCS 5/16-108.5(c)(3).

IIEC argues that this specification avoids the distortion that would arise from use of the initially proposed period formula rates (based on a higher equity premium) as the starting point. (Gorman, IIEC Ex. 1.0-C at 12:269-272). IIEC asserts if the three-year assessment is unmoored from the Commission's pre-formula revenue requirement determinations, the formula rate is evaluated against only its own performance, and its relative effectiveness would remain unexamined.

To avoid another potentially significant distortion stemming from the statutory focus on residential rates, IIEC recommends that the Commission exclude the effect of revenue requirement shifts to other (non-residential) customer rate classes through unjustified rate design/cost allocation changes. (*See*, Gorman, IIEC Ex. 1.0-C at 13-14:286-294). Given ComEd's economic incentive to maintain its formula rate eligibility, the commercial and industrial rate classes that contain IIEC members may be at risk of unwarranted cost re-allocations that serve to restrain increases in residential rates, and avoid formula rate disqualification. Excluding the effects of such re-allocations from the three-year assessment would remove that incentive to force cost re-allocations. (*Id.* at 13:291-294).

3. Other

a. Tariff Structure/Detail

Statutory and Regulatory Requirements. Section 16-108.5 requires that a formula rate tariff perform the following statutory purposes:

> specify the cost components that form the basis of the rate charged to customers with sufficient specificity [A] to operate in a standardized manner and [B] be updated annually with transparent information that reflects the utility's actual costs to be recovered during the applicable rate year . . . . (220 ILCS 5/16-108.5(c) (letters added)).

The tests in that provision are functional ones. IIEC notes that aside from the functional tests set out above, the statute is silent on the level of detail that is necessary or appropriate in an implementing tariff. IIEC stresses that the Commission is the regulatory body charged by the statute with implementing the formula rate regime, and it is the Commission -- not ComEd -- that is authorized to determine how much detail is required or sufficient for those purposes.

ComEd's Proposed Tariff. IIEC observes that ComEd has proposed an excessively detailed tariff modeled on its FERC tariff for wholesale transmission service. Naturally, ComEd is familiar with and comfortable with this tariff. IIEC points out that to the Commission and to retail ratepayers in Illinois, the proposed tariff is a novel mechanism warranting close examination. IIEC notes that ComEd's preference for a workpaper level of detail in the formula rate tariff does not make such detail either a statutory requirement or an appropriate feature under Article IX of the PUA.

IIEC's Position. In IIEC's view, the effects of the proposed tariff's excessive detail make it unreasonable, and it is inconsistent with the functions served by retail tariffs and with applicable principles of ratemaking. (*See generally*, Gorman, IIEC Ex. 1.0-C at 2-13 and IIEC Ex. 2.0 at 19-20). The proposed tariff can and should be simplified..

Problems Caused by ComEd's Excessively Detailed Proposal. ComEd opposes simplification of its proposed formula rate tariff. IIEC argues that ComEd's arguments dismiss the importance of tariff understandability and of customer participation in the regulatory process.

> I doubt Mr. Gorman seriously believes that any retail customer could pick up ComEd's or Ameren's formula supply tariff, the applicable IPA Plans, and the results of current and prior competitive procurements, read them over and thereby understand their supply charge. (Hemphill, ComEd Ex. 20.0 at 35:749-752).

IIEC notes that the unfortunate existence of commodity related tariffs that ratepayers cannot comprehend is not justification for unnecessarily adding another.

Each of the tariffs ComEd listed above (like ComEd's FERC transmission tariff model) relates to wholesale services and markets according to IIEC. The tariffs for such wholesale services are "generally reviewed by more sophisticated market participants." (Gorman, IIEC Ex. 1.0-C at 11:236-238). ComEd's formula rate tariff is for the most basic retail electric utility service -- delivery to the homes and businesses of Illinois residents. IIEC notes that even ComEd's more sophisticated retail ratepayers are concerned by the near impossible complexity of this needlessly detailed tariff. (Gorman, Mar. 12 Tr. at 739-740).

In IIEC's view, ComEd is proposing to incorporate in its tariffs the type of computational detail that is usually at the center of the Commission's regulatory review of proposed revenue and cost bases for proposed rates. IIEC asserts that the form of tariff that ComEd proposes also could hinder or needlessly complicate the Commission's exercise of its ratemaking authority and obligation for PUA Article IX review. For example, IIEC points out the Commission would have to make numerous tedious tariff revisions for every determination of just and reasonable costs or capital structure, on a different record, that varies the previously used cost input or calculation on FERC Form 1 data. (*See*, Gorman, IIEC Ex. 1.0-C at 4-6:80-129 and IIEC Ex. 2.0 at 21-22:475-505). In addition, IIEC argues, there might be limitations on the Commission's ability to modify cost inputs if the tariff is interpreted as a constraint on how the Commission determines whether a cost is prudent, just and reasonable, and how to reflect that in the formula rate calculations. (*See* Gorman, Mar. 12 Tr. at 737).

IIEC states that Section 16-108.5 explicitly commands that the Commission continue its scrutiny of proposed costs and rates in accordance with existing Article IX of the PUA, relevant law, and the Commission's customary practice, with very limited exceptions.

> The Commission shall initiate and conduct an investigation of the tariff in a manner consistent with the provisions of this subsection (c) and the provisions of Article IX of this Act to the extent they do not conflict with this subsection (c).

* * *

> Such review [of proposed rates and tariffs] shall be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act.
> (220 ILCS 5/16-108.5(c)).

IIEC contends these tasks will be significantly more difficult if the Commission's modifications of proposed cost inputs require the Commission to search for, change, and verify all tariff spreadsheet entries associated with each Commission determination or modification. For example, for the cost input modifications accepted in ComEd's rebuttal and surrebuttal testimony, ComEd presented a six-page list of associated tariff spreadsheet changes. (Fruehe, ComEd Ex. 22.8).

IIEC notes that ratepayers participating in formula rate proceedings face equally daunting requirements for objections to proposed costs and revenue requirement computations. (220 ILCS 5/16-108.5(d)). IIEC argues that approval of ComEd's proposal to include numerous schedules and appendices of workpaper details in its implementing tariff sets the stage for utility arguments to try to immunize tariffed cost inputs from meaningful examination, because particularly described cost elements or computations are incorporated in the detailed spreadsheets of ComEd's tariff. ComEd's proposed tariff is impossibly complicated, and it is not accessible to the ratepayers directly affected by it. IIEC believes the proposed tariff does not achieve the transparency required by the new statutory provisions. (*See*, Gorman, IIEC Ex. 1.0-C at 9-10:203-215 and IIEC Ex. 2.0 at 24:543-549). In IIEC's opinion, though ComEd's proposed tariff contains 12 distinct schedules and 13 appendices, it cannot "operate in a standardized manner and be updated annually with transparent information that reflects the utility's actual costs." (Fruehe, ComEd Ex. 13.1). IIEC argues that even with the detail and complexity of ComEd's proposed tariff, the tariff still lacks the link between the source data in ComEd's FERC Form 1 and the revenue requirement formula that underlies the formula rates. ComEd's proposed tariff requires extensive (nearly 150 pages) workpapers to define the tariffed formula rate's cost inputs. (Fruehe, ComEd Ex. 22.2). Thus, it cannot be "updated with transparent [cost] information" any more than the less complicated, more comprehensible tariff that IIEC recommends and describes below. IIEC believes the complexity of the tariff has been increased immeasurably -- to no real beneficial effect.

<u>IIEC's Recommendation</u>. IIEC asserts that a more understandable tariff that shows the formulaic revenue requirement determination using the major elements of the formula rate, at a level of detail that satisfies the statute, is possible. IIEC proposes that the Commission adopt Schedules FR A-1 and FR A-1-REC from ComEd's proposed tariff as the formula rate required by Section 16-108.5(c). IIEC argues that the schedules meet the statutory requirements and better serve the customary purposes of tariffs. In addition IIEC notes, that simplified tariff can be supplemented by Commission rules that would govern the formula rate process and incorporate the remaining schedules and/or workpapers ComEd has offered as mechanisms for determining its formula rates. ComEd's proposed tariff appendices and the supporting workpapers would retain the function such documentation has in the Commission's customary

Article IX reviews of proposed rates, without purporting to supplant the Commission from its proper decisive role. Because non-tariffed spreadsheets are required even with ComEd's proposed more detailed and complex tariff, standardization is not significantly diminished. But transparency, through understandability, is enhanced.

B. Ratemaking Process and Filing Issues

1. Access to Information re: Formula Rate Filing

IIEC notes the Commission has the statutory authority to determine (i) the data that need to be made available to the Commission, its Staff, and ratepayers, in the context of the annual filings required by ComEd under Section 16-108.5(d), and (ii) the process by which such information should be made available to ratepayers. Section 16-108.5 indicates that the Commission is permitted to adopt rules to implement the Section. (*See,* 220 ILCS 5/16-018.5(d)(3) (requiring that the annual filing include relevant and necessary data and documentation "that is consistent . . . with any rules adopted by the Commission to implement this Section.")). Furthermore, the Commission is empowered under Section 10-101 of the PUA to establish rules and regulations relating to investigations, inquiries and hearings concerning matters covered by the PUA. (220 ILCS 5/10-101). Lastly, the Commission is empowered under Section 16-108.5 to approve or approve as modified ComEd's formula rate pursuant to this hearing. (220 ILCS 5/16-108.5(c)(6)).

Section 16-108.5 does not specifically identify the data that ComEd must provide in order to permit the Commission to review and evaluate ComEd's annual filing. Nor does that section identify the process or procedure by which such data must be provided to ratepayers.

Thus, explains IIEC, the Commission's authority over the conduct of its proceedings remains unaltered. IIEC states the Commission can establish rules and procedures for the identification of the data it deems necessary to evaluate and review ComEd's annual filing under Section 16-108.5. IIEC also notes the Commission has the power to compel ComEd, by rule or by modification of the ComEd formula rate, to provide such information to ratepayers at the earliest possible time. (*See* IIEC Cross Ex. 3 (data availability protocols in ComEd's FERC formula tariff)).

ComEd has voluntarily made available certain data from Part 285 and 286, of the Commission's rules on rate case filings, for the applicable rate year in this case. However, IIEC points out that ComEd does not intend to set a precedent for filing the same "relevant and necessary data and documentation" in a future proceeding. (*See*, Hemphill, ComEd Ex. 1.0 at 16:311-317). IIEC argues the Commission should act affirmatively to identify the data it deems relevant to its duty to determine whether the costs in ComEd's annual filings are prudent and reasonable and to ensure such data is provided to ratepayers, or their designated representatives, at the earliest possible time. IIEC contends the Commission and ratepayers should not be required to rely on the utility to be the exclusive arbiter of what data is relevant or whether only the data described in Parts 285 and 286, or a subset thereof, are relevant to the determinations the Commission must make.

IIEC believes the establishment of rules, protocols, or procedures to ensure relevant data is made available at the earliest possible time is critical. The Commission has only 45 days to determine whether it will conduct a hearing under Section 16-108.5(d) and the Commission's current Rules of Practice do not grant the parties any discovery rights until a hearing has been initiated. (83 Ill. Adm. Code Part 200.10 (indicting intervenors have discovery rights, in "docketed proceedings")). Further, in formula rate proceedings, the time period for ratepayers to present their case is extremely short. Section 16-108.5 provides that the Commission has 240 days from the date of the annual filing to enter an order determining the prudence and reasonableness of the utility's costs. IIEC points out that if the Commission takes the full 45 days to evaluate the Company's filing, ratepayers will have only 195 days in which to conduct discovery and present their cases. Furthermore IIEC notes that some parties perceive a possible shift in the evidentiary burdens in such cases, to the disadvantage of ratepayers. (*See*, Knight-Garlish, Staff Ex. 23.0, Att. A, Part 1 at 5, where Fitch Ratings Agency opines that "although the ICC continues to have authority to investigate the prudence and reasonableness of expenditures (under the new formula rate legislation), the burden of proof has been shifted from the utility to the intervening parties." (Explanation added)).

IIEC asserts that under such circumstances the Commission is empowered to act, and it should take all reasonable steps to require ComEd to provide all of the data and explanatory information ratepayers need to examine the annual filings at the earliest reasonable time.

IIEC has proposed that ComEd be required to provide the data from Part 285 and Part 286 of the Commission's Rules that the Commission deems relevant. (Gorman, IIEC Ex. 1.0-C at 7:159-160). IIEC notes that Section 16-108.5 does require annual reconciliation filings to contain relevant and necessary data and documentation consistent with rules relating to general rate case filings for the applicable rate year. (220 ILCS 5/16-108.5(d)(3)). However, IIEC adds the formula rate statute does not identify the relevant and necessary data or documentation to be included. Nor has ComEd committed to allowing any type of discovery on the filing or the data provided with the filing prior to the Commission's initiation of a hearing. ComEd witness Fruehe suggested that the Company would be willing to respond to inquiries about its filed Form 1, but IIEC says ComEd apparently continues its opposition to, and has not committed to, specific disclosure requirements. Therefore, IIEC has also recommended that the Commission consider regularly establishing a docket for the receipt and review of the Company's annual filing. IIEC finds that such an open docket (either kept open or initiated each January 1) would ensure that data is made available to ratepayers or their designated representatives through direct service to parties or by filing of the data in the docket, so that it would be immediately available through the Commission's electronic filing system for docketed proceedings. IIEC also points out that such a procedure also would facilitate timely discovery in a time-limited proceeding.

IIEC notes there is precedent for such processes in other states. For example IIEC states in Missouri, all parties participating in any proceeding in which the Commission adopts a fuel adjustment rider become permanent intervenors for the purpose of any subsequent reconciliation proceeding. (*See*, MO Code of State Regulation, 4 CSR 240-3.161(10)). IIEC believes, given the Commission's authority to make the rules necessary to conduct its proceedings, including

Section 16-108.5 proceedings, there is little question that the Commission has the authority to establish appropriate processes for effective review of annual formula filings. (220 ILCS 5/10-101). IIEC asserts that appropriate rules and docketing would guarantee ratepayers and their authorized representatives access to the data needed to evaluate the utility's annual filing and to initiate discovery on same at the earliest possible time.

Also IIEC believes the Commission should require ComEd to make available to ratepayers and their authorized representatives, its annual FERC Form 1 as soon as ComEd presents that form to the Federal Energy Regulatory Commission. For example, ComEd could file that form in the continuing (or early opened) docket initiated by the Commission pursuant to IIEC's recommendation above. IIEC finds that this simple procedural step could avoid any delays from having to gain access to the form through FERC only after it makes the document publicly available.

Finally, IIEC recommends that the Commission order all conclusions associated with metrics related to quality and reliability of service be filed with ComEd's annual filing under Section 16-108.5. This information is needed to assess whether ComEd is complying with the Commission's service quality and reliability minimum standards, which in turn is needed, in IIEC's opinion, to determine if incentive compensation costs should be included in the formula rate as a reasonable cost. (*See*, VIII.B.3. below).

2. Triggers for Hearing on Certain Operating Costs

IIEC proposes that a procedural cap be set for regulatory expenses and affiliate charges included in the formula rate. The cap acts as a trigger. If ComEd proposes to include a level of regulatory expense and affiliate charges in excess of the cap in the formula rate, the Commission will initiate a hearing to determine whether the level of expense requested by ComEd is prudent and reasonable. (Gorman, IIEC Ex. 1.0-C at 15:340-350).

a. Regulatory Expense

IIEC proposes a cap of $2.4 million for regulatory expense. This is the level of regulatory expense approved for ComEd in its last rate case in Dkt. 10-0467. (*Id*. at 16:368-370). IIEC argues this cap will encourage ComEd to aggressively manage its regulatory expenses in the context of the new formula rate approach. Under this new approach, emphasis is placed on recovery of ComEd's actual costs. IIEC notes the Commission is given only a short period of time to review the annual filing to determine whether or not it will conduct a hearing to determine the prudence and reasonableness of costs the Company proposes to recover. IIEC points out that, absent a rule or tariff modification, ratepayers have not been granted a right to participate promptly in the review of the filing or to conduct discovery on same. Under the circumstances IIEC believes a cap would encourage aggressive management of this expense. IIEC notes that a cap would also provide assurance of regulatory oversight and discipline of regulatory expense that benefits customers and helps ensure the justness and reasonableness of the formula rate. (*Id*. at 16:353-360).

IIEC asserts the $2.4 million cap is reasonable because it reflects regulatory expenses associated with a traditional rate case approach and the formula rate approach is likely to involve a lower regulatory expense level. (*Id*. at 16:369-373). Under the circumstances, it is reasonable to assume that a regulatory expense level in excess of the amount associated with traditional rate cases may be imprudent and unreasonable, and so warrants a hearing. IIEC notes that ComEd would still have the opportunity to demonstrate that its requested level of regulatory expense was prudent and reasonable in such a hearing.

b. Affiliate Charges Expense

IIEC recommends that the level of affiliate charges expense approved in ComEd's last rate case in Docket 10-0467 be set as the procedural cap or trigger for ComEd's formula rate. ComEd should be required to identify all affiliate charges included in the Final Order in Docket 10-0467 to establish the dollar value of this cap. This cap, like the cap on regulatory expense, would operate as a trigger. To the extent ComEd's affiliate charges expense exceeded the cap, a hearing on prudence and reasonableness would be initiated. IIEC concludes the reasons for this cap are essentially the same as the reasons for the cap on regulatory expense discussed above.

c. Legal Authority for Caps/Triggers

IIEC finds the Commission is empowered to approve ComEd's formula rate as modified, and to make rules to administer Section 16-108.5. (220 ILCS 5/16-108.5(c)(6) and (d)(3)). The Commission also has the right to conduct hearings on the prudence and reasonableness of the utility's proposed costs. (220 ILCS 5/16-108.5(3)). IIEC does not find a prohibition on the Commission's ability to advise the utility, in advance, of the circumstances under which it will initiate such a hearing. IIEC concludes that because the Commission is authorized to establish procedures and related conditions by rule or through tariff modification, the Commission is empowered to establish the caps/triggers discussed above.

3. Performance Condition for Incentive Compensation Costs

IIEC proposed a limitation on incentive compensation that would be included in the formula rate. Incentive compensation would be recoverable under the formula rate only to the extent the reliability metrics for ComEd and ultimately adopted by the Commission are satisfactorily met. (Gorman, IIEC Ex. 1.0-C at 15:333-338). IIEC suggests that the minimum operational metrics standards ComEd must meet should be the standards described in Section 16-108.5(f). These standards are the subject of a Commission proceeding in Docket 11-0772. (*Id*. at 18:410-413). Section 16-108.5 includes language which provides that ComEd's formula rate "shall" ". . . permit and set forth protocols for recovery of incentive compensation based on the achievement of operational metrics. . .. (220 ILCS 5/16-108.5(c)(4)(A)).

IIEC argues that the incentive compensation expense to be included in the formula rate should be structured so that achieving or exceeding the metric thresholds (whatever the metrics ultimately approved by the Commission) would allow ComEd to include that expense in its formula rate to the extent it is otherwise recoverable. IIEC finds that failure to achieve the metrics would mean that no incentive compensation expense could be included in the formula rate. (Gorman, IIEC Ex. 1.0-C at 18-19:416-419).

IIEC asserts that Section 16-108.5 was designed, in part, to encourage infrastructure investment and modernization to improve reliability and service quality for customers. As part of that plan, certain metrics were established that the utility must meet to continue operating under the performance-based formula. These metrics are described in subsection (f) of Section 16-108.5. (220 ILCS 5/16-108.5(f)). Consistent with the provisions of Section 16-108.5, IIEC has recommended that those metrics be used to help assess ComEd's recovery of incentive compensation. If ComEd does not meet those metrics, incentive compensation should not be reflected in the formula rate. (Gorman, IIEC Ex. 1.0-C at 20:440-443). IIEC argues that a failure to meet the operational metrics that form the basis of incentive compensation recovery is an indicator that the expense is not prudently or reasonably incurred and inclusion in the formula rate could result in a rate that is not just or reasonable.

In order to accomplish this goal, IIEC recommends the Commission should also require that ComEd include with its annual filing, the information necessary to allow the Commission to determine whether or not ComEd has achieved the metrics approved by the Commission. (*See*, VIII.B.1. above).

C. Reconciliation

1. Average Rate Base Proposals (see also III.C.1)

IIEC has addressed the use of an average rate base versus a year-end rate base for ComEd's formula rate in Section III.C.1. above. IIEC favors the use of an average rate base as opposed to a year-end rate base for the calculation of ComEd's formula rate.

2. Interest Rate Proposals

IIEC has addressed the appropriate interest rate on formula rate reconciliation computation ("reconciliation balances"). (*See*, Gorman, IIEC Ex. 2.0 at 6-8:141-195). IIEC recommends the Commission adopt the Staff or AG/AARP's interest rate proposals. Staff witness Ebrey proposes the use of customer deposit rates for reconciliation balances. (Ebrey, Staff Ex. 1.0-C at 17:330-333). AG/AARP witness Brosch proposes the use of short-term debt rates for reconciliation balances. (Brosch, AG/AARP Ex. 1.0 at 17:370-377).

IIEC observes ComEd opposes the use of the short-term debt rates because, according to the Company, short-term debt issued and outstanding during the formula rate true-up period is used either to support rate base or CWIP. (*See*, Houtsma, ComEd Ex. 12.0 at 36:789-791). ComEd reasons that identifying short-term debt as the funding source used to determine the reconciliation interest rate would double count the of short-term debt. (Gorman, IIEC Ex. 2.0 at 6:147-150).

With regard to the use of customer deposit rates for the reconciliation balance, ComEd argues that customer deposits are deducted from rate base and thus are not a capital source available to fund the reconciliation balance. Therefore, IIEC believes use of customer deposit rates and short-term debt rates are not appropriate for determining the carrying charges on the reconciliation balance. (*Id*. at 7:151-154).

As noted above, IIEC supports either the use of short-term debt rates (AG/AARP) or customer deposit rates (Staff) for the reconciliation balance. IIEC notes the arguments ComEd has made against the use of these interest rates could also be made against ComEd's proposed use of the Company's overall rate of return on rate base or primarily long-term debt to fund the reconciliation balance. *(Id.* at 7:156-158). IIEC believes it is highly unlikely ComEd would issue additional common stock or long-term debt to fund what is essentially a temporary reconciliation balance, which would be collected from customers over a period not to exceed three years. (Gorman, IIEC Ex. 2.0 at 7:158-161). IIEC believes it makes no sense to issue long-term debt to fund a short-term reconciliation balance that will be paid off in no more than three years. Therefore IIEC believes, the most reasonable and logical interest rate on reconciliation balances is the rate on the Company's short-term capital sources, such as short-term debt or customer deposit interest rates as proposed by AG/AARP and Staff.

Any concern about the use of short-term debt and customer deposits to finance rate base also has limited implications on the appropriate rate for temporary reconciliation balances in IIEC's view. (*Id*. at 8:179-182). Customer deposits and short-term debt vary during the year but the formula rate considers the balance at the beginning and end-of-year period. Thus, the precision necessary to properly track the amount of short-term debt and/or customer balance available to support rate base and8/or reconciliation balances is lacking. (*Id*. at 8:191-195). IIEC finds the short-term debt and customer balances supporting rate base and/or reconciliation balances cannot be traced with the detail ComEd seeks. (*Id*. at 8:183-186).

Under the circumstances, IIEC finds use of either short term debt rates or customer deposit rates for the reconciliation balance is reasonable.

X. CONCLUSION

For the reasons stated herein, IIEC respectfully requests the Commission adopt the positions taken and recommendations made by IIEC herein.

DATED this 11th day of April, 2012.

Respectfully submitted,

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